



Fitch Affirms San Diego Public Facilities Fin Auth, CA Wastewater Revs at 'AA'; Outlook Stable [Ratings](#) [Endorsement Policy](#)

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Fitch Ratings-Austin-14 March 2012: Fitch Ratings affirms its 'AA' rating on the following Public Facilities Financing Authority of the City of San Diego, California (the authority) bonds issued on behalf of the City of San Diego, California (the city):

-- \$1.1 billion senior sewer revenue bonds.

The Rating Outlook is Stable.

SECURITY

The bonds are secured by revenues which consist primarily of installment payments made by the city to the authority. The city's obligation to make installment payments constitutes a senior lien on net revenues of the city's wastewater system (the system).

KEY RATING DRIVERS

Solid Financial Results: The system's financial performance is good and benefits from prudent formal policies and reserves.

Moderate Leverage to Improve: Leverage ratios are moderate overall and are expected to improve over the forecast period as a result of reduced capital needs and increased equity funding for capital.

Rates Holding Steady: Rates are moderately high but are expected to remain unchanged over the forecast period.

Extensive Service Territory: The service area is broad and diverse.

WHAT COULD TRIGGER A RATING ACTION

Reduced Financial Strength: Maintenance of sound financial metrics will be key to preserving credit quality.

Capital Escalation: Conversion of the system's Point Loma Wastewater Treatment Plant (PLWTP) to full secondary treatment, if required at some point in the future, could add significant pressure to financial and leverage ratios.

CREDIT PROFILE

System financial performance is good and includes strong liquidity and favorable cash flows. For fiscal 2011, the system maintained over 770 days cash while free cash generated from operations equaled 117% of depreciation expenses. Annual debt service (ADS) coverage of all debt was also sound in fiscal 2011 despite a 6% decline in operating revenues resulting from water use restrictions and no rate increase for the year. Overall, total ADS coverage was just under 1.7 times (x) in fiscal 2011 and was virtually unchanged from fiscal 2010. Financial projections provided by management, which appear reasonable to Fitch, anticipate a slight erosion in ADS coverage through fiscal 2016 resulting from limited additional debt issuance without further rate hikes. Maintenance of satisfactory ADS coverage will be important to preservation of the current rating.

Capital needs for fiscals 2012-2016 total around \$485 million and are around 25% lower than the fiscal 2010-2014 capital improvement program (CIP). The reduced costs are largely attributable to favorable construction cost estimates and completion of prior projects. Debt levels remain moderate, but should decline over the immediate future because of sharply lower anticipated borrowing amounts to fund the CIP and a transition towards equity funding for the majority of the CIP. Indeed, total borrowings for the fiscal 2012-2016 CIP are just one-quarter the estimates for the fiscal 2010-2014 CIP. While the planned reduction in CIP costs and associated borrowing is favorable, capital costs could escalate substantially in subsequent years to meet future discharge requirements and necessitate higher borrowing amounts, particularly if the system is required to convert the PLWTP to full secondary treatment standards.

Currently, PLWTP operates under a 301(h) waiver of the federal Clean Water Act, allowing the facility to treat to advanced primary standards. The city received its most recent waiver in August 2010, which expires in July 2015. However, it is likely that sometime after the expiration of the renewed permit that additional enhancements to the system will be required, which could include conversion of PLWTP's treatment process to full secondary. While the city will be working with regulators in the intervening timeframe to evaluate possible enhancements to the system without such a conversion of PLWTP, if the facility is required to upgrade to full secondary, capital costs are currently forecasted to be as high as \$1.5 billion. Fitch will continue to monitor regulatory developments and assess the possible impact they could have on the system's credit profile.

The system provides retail service to around 1.3 million people within the city and also provides wholesale service to approximately 800,000 people in the outlying area. The city's diverse economy is driven by healthcare, military, tourism, and educational sectors. Economic conditions in the city have shown positive signs in recent months, with job growth in the city expanding by 1.6% in 2011 compared to the national rate of 1.0%. While unemployment of 8.9% for December 2011 remained above the national rate of 8.3%, the recent level of job creation has narrowed the gap with the national average and positions the city for continued positive movement.

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Additional information is available at 'www.fitchratings.com'. The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.

Applicable Criteria and Related Research:

- 'Revenue-Supported Rating Criteria', June 20, 2011;
- 'U.S. Water and Sewer Revenue Bond Rating Criteria', August 10, 2011;

For information on Build America Bonds, visit 'www.fitchratings.com/BABs'.

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[U.S. Water and Sewer Revenue Bond Rating Criteria](#)

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